Mandatory joint audits in France and Denmark: a comparative case study

In one of its recent publications on joint auditing, the H3C noted that an imbalance in the allocation of audit work between auditors had been observed in some cases, leading to inefficient application of the system. The publication was based in particular on a study by Professor Olivier Marnet (University of Southampton), who described the Danish experience and noted that this legislation, which has now been repealed, did not contain a specific rule on how joint work should be shared between auditors of the same entity[1] .

Another academic study, recently published on the Social Science Research Network website[2], helps to understand and compare the emergence and evolution of mandatory joint auditing in France (the "co-commissariat aux comptes") and Denmark (the "*To-Revisor*" system). The article describes the emergence and institutionalisation of these two models, the emergence of structural changes in the audit profession and the outcome of these changes, i.e. the continuation of joint audit in France and the marginalisation and subsequent abandonment of joint audit in Denmark.

Contributions of the study

The article first recalls that in joint audit systems, the financial statements are audited by two or more independent auditors from different audit firms. This implies coordination of audit planning, sharing of audit procedures, cross-review of those procedures and joint responsibility of the joint auditors for the single audit report issued and signed by them.

Secondly, the authors of the article recall that in France and Denmark, joint audits were introduced in the 1930s in response to financial scandals. Subsequently, French and Danish laws required the appointment of two auditors in listed companies in 1966 and 1973 respectively. However, the increasing development of large audit firms in France and Denmark in the 1980s and 1990s structurally changed the profession and led to a concentration of the audit market.

In France, the public authorities have taken steps to prevent the marginalisation of joint auditing. Thus, in 1984, a mandatory joint audit was introduced for consolidated accounts. In 1993, the appointment of joint auditors belonging to the same firm was prohibited. In 2007, the professional practice standard NEP 100 was adopted. This standard requires auditors to consult each other during the various phases of the audit, to divide the audit work evenly and to review each other's work in order to issue a joint opinion report. In 2007 and 2012, the French audit regulator - the H3C - issued opinions on the application of the professional practice standard NEP 100, including examples of unbalanced work allocation between joint auditors. The adoption of these measures has helped to maintain the French model of joint auditing.

In Denmark, a note adopted in 1995 recommended the involvement of both auditors in the different phases of the audit assignment - planning, risk assessment, audit procedures, cross-

[1] See the H3C website for the communication entitled *"H3C-Joint audit in France"* of April 2022

[2] *"Mandatory joint audits in France and Denmark: A comparative case study"* by Fatma Jemaa (Copenhagen Business School - Department of Accounting), Kim Klarskov Jeppesen (Copenhagen Business School - Department of Accounting) and Nadia Mhirsi (University of Burgundy - Institut d'Administration des Entreprises (IAE) de Dijon - CREGO (EA 7317)), dated 22 February 2022.

review and reporting - but did not provide for a minimum level of involvement of each joint auditor. In the absence of regulation, unbalanced work between joint auditors became common practice in the 1990s, leading to the erosion of the Danish model. This increased imbalance of work between the joint auditors opened the door to the "*lunch auditor*", a term describing a situation in which the entire audit is carried out by one auditor while the second auditor attends only a few meetings, reads the audit plan and the summary note and signs the opinion report. Although *lunch auditing* situations were apparently not widespread, the terms "*lunch auditors*" and "*second auditors*" have become common and have remained associated with joint auditing. Following a major financial scandal involving a listed company, the Danish Parliament passed a law in 2001 ending the joint audit requirement, making the appointment of more than one auditor in listed companies optional. In Denmark, in 2005, 68% of listed companies opted for a single auditor. In 2006, 78% of listed companies opted for a single auditor, in 2007 82% and in 2019 98%.

The study concludes that although mandatory joint auditing alone cannot solve the problems of market concentration and failure to detect significant fraud, it can be part of the solution if the quality and diversity of joint auditors are ensured in practice. This implies, inter alia, consideration of the following: a concerted audit approach and work planning, a balanced allocation of audit procedures, a cross review of those audit procedures, joint discussions with the management of the audited entity and the issuance of a joint report.

Finally, the article points out that a recent series of financial scandals has brought to the forefront the issue of mandatory joint audits as a measure to mitigate audit market concentration and prevent fraud. Indeed, the UK and the Netherlands have recently discussed the benefits of mandatory joint audit, noting in particular the moderate concentration of the audit market in France and the relatively low number of financial scandals in France due to serious deficiencies in statutory controls.

H3C comments

As discussed in this recent academic study, measures have been adopted to maintain the French joint audit model (Article L. 823-15 of the Commercial Code, professional practice standard NEP 100, Article 24 of the Code of Ethics and H3C opinions 2007-07-01 of 22 November 2007 and 2012-01 of 9 February 2012).

These measures provide for the following rules:

- the joint auditors must belong to separate professional structures;
- with regard to the division of work between the joint auditors :
  - each auditor carries out work that enables him or her to formulate an opinion on the entity's accounts as a whole;
  - Each auditor shall obtain an understanding of the entity and its environment, assess the risks of material misstatement at the level of the accounts as a whole, and determine the materiality level(s) for the purpose of defining and formalising, together with the other auditor, their audit approach and the planned audit plan and procedures;
  - the audit procedures necessary for the implementation of the engagement plan and defined in the work programme are allocated in a concerted manner among the auditors;
  - the distribution of work among the auditors is balanced and carried out according to qualitative and quantitative criteria;

- each auditor reviews the work performed by the other auditor, such a review is called a cross review;
- Each auditor should document in his or her own file the review evidence to support his or her assessment of the work performed by the other auditor. This documentation should demonstrate that the other auditor has gathered sufficient appropriate evidence to support the audit assertions.

For the past 15 years, one of the priority themes of the H3C's inspections, and of the inspections delegated to the CNCC and supervised by the H3C, has been to verify the correct application of the professional practice standard - NEP 100 - relating to joint auditing and, in particular, to verify (i) that the joint auditors have consulted each other on the audit approach, (ii) the balanced nature of the division of work between the joint auditors and (iii) the quality of the documentation of the cross-review check. Thanks in particular to these controls, the various communications from the H3C and the CNCC and the commitment of professionals, the vast majority of joint audits are now conducted in a balanced and effective manner.

Thus, the French model of joint auditing contributes to strengthening confidence in financial statements and contributes to financial security.

For more information, see in particular:

- the latest H3C communications on joint auditing published in April 2022
- the Joint-Audit Day presentations organised by the H3C on 29 November 2021